ARAB MALAYSIAN FINANCE BHD

v.

SUKMA VILLA SDN BHD & ORS

HIGH COURT MALAYA, JOHOR BAHRU
SYED AHMAD HELMY JC
[CIVIL SUIT NO: 22-706-1998]
11 AUGUST 2001

CONTRACT: *Interest - Loan agreement - Financier increased interest from 1% to 4% upon termination and recall of loan agreement - Whether increased interest amounted to a penalty under s. 75 Contracts Act 1950 - Whether right to vary interest contractually provided for - Whether increase was unreasonable - Whether within permissible guidelines laid down by central bank*

Upon the default of the defendants under a loan agreement cum assignment ('the agreement'), the plaintiff terminated the agreement and recalled the loan with an increased margin interest from 1% to 4%. The increase to 4% was the maximum rate allowed by the central bank of Malaysia, Bank Negara. It was the defendants' case that the said increase amounted to a penalty and was caught by s. 75 of the Contracts Act 1950 which required the plaintiff to prove its losses.

Held:

[1] The right of the plaintiff to charge margin interest and penalty interest was contractually provided for by cls. 4.05(1) and 4.07(2) respectively of the agreement. Hence, the plaintiff had proven its contractual right to such interests. As cl. 4.06 enabled the plaintiff to vary the margin interest, the plaintiff was clearly entitled to increase the same from 1% to 4% upon due notification to the defendants which was duly given and not challenged by the defendants. (p 393 e-g)

[2] Section 75 of the Contracts Act 1950 was not applicable as the increase in the said interest was contractually provided for. Even if s. 75 was to apply, the increased rate from 1% to 4% was not unreasonable. Further, being within the permitted guidelines as laid down by Bank Negara, the increase in the interest was not against public policy. It followed, therefore, that it could not be a penalty. (pp 393 g-h, 394 a-b)

[Judgment for plaintiff.]

Case(s) referred to:

Bumiputra Merchant Banker Bhd v. The Melewar Corporation Bhd & Ors [1990] 2 CLJ 30; [1990] 1 CLJ (Rep) 693 ***(foll)***

Dunlop Pneumatic Tyre Co Ltd v. New Garage & Motor Co Ltd [1915] AC 79 ***(refd)***

Hadley v. Baxendale [1854] 9 Exch 341 ***(refd)***

Realvest Properties Sdn Bhd v. The Co-operative Central Bank Ltd (under receivership) [1996] 3 CLJ 823 ***(dist)***

Selva Kumar Murugiah v. Thiagarajah Retnasamy [1995] 2 CLJ 375 ***(dist)***

Legislation referred to:

Contracts Act 1950, s. 75

For the plaintiff - KP Khoo; M/s Tan & Lee
For the defendants - CM Owee; M/s Joseph Yeo

Reported by Usha Thiagarajah

JUDGMENT

Syed Ahmad Helmy JC:

The action herein by agreement of the parties was for the determination of the question whether the plaintiff is entitled to charge penalty interest and if so, the rate thereof, and whether the same can be increased after termination of the agreement.

There is no dispute whatsoever as to the principal amount owing and except for the question of penalty interest there is no dispute as to the validity of the loan agreement and assignment and the guarantee and also the parties as agreed as to the bundle of documents.

The plaintiff's case was canvassed through its Skudai Branch Assistant Manager, Puan Ngae Fang Fang (SP1) and though the defendants through their solicitors informed the Court that they will be adducing evidence through two witnesses, none was called and hence there is no evidence presented on behalf of the defendants in relation to the determination of the issue aforesaid.

The plaintiff through SP1 adduced evidence to the effect that the letter of offer stipulates the margin interest that is leviable which is 1% above the base interest rate, and the right of the plaintiff to levy such margin interest and base interest is found in cl. 4.05(1) of the loan agreement cum assignment at p. 40 of the bundle of documents. By cl. 4.06 at p. 50 of the bundle there is provision for the plaintiff to vary the interest rate aforesaid.

SP1 further states that upon default by the defendants and termination of the loan agreement cum assignment by the plaintiff, the plaintiff varied the interest rate of the margin interest from 1% to 4% and notified the defendants of the interest rate chargeable of 18.35%.

The increase of the margin interest to 4% is the maximum rate allowable by Bank Negara in relation to the margin interest and it is SP1's evidence that the maximum rate was imposed upon termination and recalling of the loan.

The defendants did not adduce any evidence in rebuttal to the evidence of the plaintiff as presented through SP1 and proceeded to submit that the increase in the margin interest rate can only be imposed upon default and the plaintiff has failed to adduce evidence that Bank Negara's ruling allows for the charging of the maximum increased rate of 4%. By levying maximum margin interest of 4% the defendants contend that levying and the variation thereof amounts to a penalty and is caught by the provisions of s. 75 of the Contracts Act 1950 which necessitates the plaintiff to prove its losses – and relies on the case of *Selva Kumar a/l Murugiah v. Thiagarajah a/l Retnasamy* [1995] 3 CLJ 375 and *Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Co. Ltd* [1915] AC 79. By reason thereof and in the absence of any express provision for the charging of 4% margin interest upon default, the plaintiff is not entitled to charge the same, more so in the absence of any proven losses.

The right of the plaintiff to charge margin interest and penalty interest is contractually provided for by cls. 4.05(1) and 4.07(2) respectively of the loan agreement cum assignment and hence since the agreement specifically provides for the imposition of such interest, it is my finding that the plaintiff has proven its contractual right to such interest.

From the unrebutted evidence of SP1 the rate of penalty interest of 1% as stipulated in the letter of offer remains unchanged and though the margin interest of 1% is also expressly stipulated in the letter of offer and the loan agreement, nevertheless in the light of cl. 4.06 enabling the plaintiff to vary, the plaintiff is clearly entitled to increase the same from 1% to 4% upon due notification, which notification was duly given and is not challenged by the defendants.

Since it is contractually provided for the defendants' contention that the increase would offend the provisions of s. 75 Contracts Act 1950 cannot be sustained. As was held in the case of *Bumiputra Merchant Banker Berhad v. The Melewar Corporation Bhd & 2 Ors* [1990] 2 CLJ 30; [1990] 1 CLJ (Rep) 693:

> In relation to the imposition of interest of 2% per annum over the prescribed rate of default as being contrary to ss. 74 & 75 of the Contracts Act 1950; since this additional interest of 2% per annum was an agreed term which was incorporated into the loan agreement, the defendants cannot now raise any objection to the imposition of such a rate and therefore ss. 74 and 75 of the Contracts Act do not apply.

Even if I were to subscribe to the defendants' submission that s. 75 Contracts Act 1950 is applicable, it should be observed that the sum awarded must be reasonable and in the context of this case the question is whether the increase in the margin interest is reasonable.

Section 75 Contracts Act 1950 empowers the court to ascertain the reasonable compensation to be awarded – it does not in any way restrict the court's discretion from making any award. In fact since under s. 75 Contracts Act 1950 any sum named in the contract is to be treated as a penalty it behoves on the court to determine what is the reasonable compensation "whether or not actual damages or loss is proved to have been caused thereby."

Though the Federal Court in *Selva Kumar*'s case ruled that the words in inverted commas aforesaid must be given a restricted meaning in the sense that there must be proof of actual damages or reasonable compensation within the settled principles in *Hadley v. Baxendale* [1854] 9 Exch. 341 nevertheless the Federal Court also held that for cases where the court finds it difficult to assess damages for the actual damage as there is no known measure of damages employable, and yet the evidence clearly shows some real loss inherently which is not too remote, the words in question will apply.

In *Selva Kumar*'s case the element of unreasonableness in the form of forfeiture of the whole 80% purchase price paid was present and hence the court felt it was warranted to intervene and apply s. 75 of the Contracts Act 1950 to strike down the unreasonableness.

In the case at hand the imposition of the increase in the margin interest cannot be said to be unreasonable, more so when it is within the permitted guidelines as laid down by Bank Negara. In the circumstances not only is it not unreasonable but also cannot be treated as a penalty.

The presence of the element of unreasonableness was again emphasised in the Federal Court decision of *Realvest Properties Sdn Bhd v. The Co-operative Central Bank Ltd (under Receivership)* [1996] 3 CLJ 823. In that case the default interest rate of 20% was paid side by side with the interest calculated at the prescribed rate of interest of 14.5% per annum – in effect there was a second additional payment of interest on the same money lent or owed and it became payable in addition to the normal payment of interest on the same money lent or owed at 14.5% per annum. It was on that basis that the Federal Court held that the offending clause was void and unenforceable by virtue of s. 75 of the Contracts Act 1950.

In the instant case there was no additional charge of interest over the moneys lent and capitalised interest – there was a variation in the form of an increase in the interest charged under margin interest from 1% to 4% which distinguishes itself from the offending clause in *Realvest*'s case. Further it should be observed that the rate of increase in the margin interest rate from 1% to 4% cannot be said to be exorbitant and hence unreasonable and being within the permissible Bank Negara guidelines it cannot be against public policy.

As evidence has been adduced in respect of the part payment of RM9,078 in November 1998 I accordingly enter judgment in favour of the plaintiff herein for the reduced sum of RM657,371.43, interest at the rate of 18.35% per annum with daily rests from 4 September 1998 until settlement and cost to be agreed failing which it is to be taxed and paid by the defendants to the plaintiff.